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IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

No. 451

ANDREW W. COMSTOCK, a holder of Missouri Pacific Railroad Company 5¼% Secured Serial Gold Bonds, on behalf of himself and others holding upward of $900,000 principal amount of said bonds,

Petitioner,

VS.

GROUP OF INSTITUTIONAL INVESTORS, holding First and Refunding Mortgage 5% Gold Bonds of Missouri Pacific Railroad Company, et al.,

Respondents.

PETITIONER'S REPLY BRIEF

WILLIAM H. BIGGS,
Attorney for Petitioner,
Security Building,
St. Louis 2, Missouri.

PHILLIP I. BLUMBERG,
of Counsel.

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POINT I

This case presents no factual controversy. Respondents' suggestion that petitioner seeks a new trial is unwarranted.

There is no factual controversy before this Court. Thus, a substantial portion of the claim of the Missouri Pacific R. R. Co. (hereinafter called MOP) against its dominated subsidiary, the New Orleans, Texas & Mexico Ry. Co. (hereinafter called NOTM), is based on repeated MOP advances to NOTM consistently matched within a

few days by NOTM dividends to MOP in substantially equivalent amounts. The District Court so found (R. 19).*

Similarly, another substantial portion of the MOP Claim involves the bookkeeping transaction, six months before bankruptcy, by which MOP wrote up the indebtedness of NOTM to MOP by $1,261,009, without one penny of cash changing hands. The District Court so found (R. 22).

Petitioner is concerned with the legal significance of these undisputed facts. Do such transactions give rise to a *valid* claim? Do such transactions give rise to a *prior* claim? These are questions of law.

Most of the remainder of the Claim arises from sums advanced by a parent to its dominated subsidiary to enable it to finance an expansion program dictated by the parent. The subsidiary, then in need of funds, was unable to borrow from the public, and was already borrowing from the parent to pay dividends in excess of earnings. These undisputed facts also present a question of law.

If a substantial part of the MOP Claim is invalid, can the remainder of the Claim—so intimately involved with the dividend program and the write-up—be endowed with validity? Further, may a parent by the facile device of denominating such sums as "advances", rather than as additional capital investments, insert a claim against its dominated subsidiary ahead of the claim of public investors?

The decision of this Court on the validity and priority of the MOP Claim will be of cardinal importance in reorganization law. This Court set up standards of conduct for fiduciary parents in the *Deep Rock* case. *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307 (1939).

The decisions of the courts below whittle away that salutary doctrine. The question before this Court is one of law: will this Court permit the impairment of the *Deep Rock* doctrine?

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* References to the transcript of the record are indicated by the letter "R", except for Volume IV thereof, which is indicated by "R. IV". References to the volumes of Exhibits are indicated by the letters "Ex." Arabic numerals in all instances indicate pages.

POINT II

The Courts below erred in refusing to disallow or subordinate the MOP Claim.

On the record before this Court, the MOP Claim must be disallowed or—to the extent, if any, not disallowed—subordinated.

The Baldwin Improvement Program Cannot Impart Validity and Priority to the MOP Claim.

The Baldwin Improvement Program is the basis of respondents' case and of the decisions of the Courts below. It is asserted as the answer to the charge of MOP mismanagement.

Respondents urge that the men who conceived and carried out the Baldwin Improvement Program—beneficial to NOTM—would not have wanted to mismanage or injure NOTM (Group Brief, p. 58).

We shall not repeat the contention in our main brief that such operational benefits are no bar to disallowance or subordination (pp. 50-51).

We here point out the following:

General beneficence is no justification for a single wrongful act. An improper transaction between parent and subsidiary is not purged because the parent has otherwise benefited the subsidiary or has not overreached the subsidiary by other means.

The test of *Pepper* v. *Litton*, 308 U. S. 295 (1939), is that each transaction imposed on the subsidiary must have "inherent fairness" and meet the requirements of an "arm's length bargain". This Court expressly held that good faith alone is insufficient (308 U. S. at 306-307).

In urging the invalidity and subordination of the MOP Claim, we are not contending that a parent is a guarantor. We do not seek by way of hindsight to penalize a parent for its mistakes.

We contend that a fiduciary parent does not have a valid and prior claim in reorganization when it has made advances to a subsidiary repeatedly matched by simultaneous dividends to the parent, when it has written up the subsidiary's indebtedness to itself, and when it has caused such a subsidiary in need of funds to finance an expansion program out of further borrowings from the parent.

The validity and priority of the MOP Claim must be determined in the first instance by the legality and fairness of its components. Each of these components must be judged on its own merits.

If a component part of the Claim is illegal or unfair, the Claim must be disallowed or subordinated to that extent. Respondents * so concede (Group Brief, p. 62). Such disallowance or subordination is mandatory, irrespective of the legality and fairness of other transactions between MOP and NOTM and irespective of MOP's alleged good faith.

Furthermore, disallowance or subordination may be required although the components of the MOP Claim are not individually shown to be unlawful or even imprudent or unfair.

Respondents, however, assert that subordination for "alleged wrongful acts of MOP mismanagement, many of which are not even remotely connected with the claim"

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is unjustified (Group Brief, p. 62). This contention is contrary to the doctrine of the *Deep Rock* case.*

In the *Deep Rock* case, the parent's compromise claim, which was in issue before this Court, was composed solely of items which were indisputably both legal and fair. *Taylor v. Standard Gas & Electric Co.*, 306 U. S. 307 (1939); 96 F. (2d) 693, 700-701 (C. C. A. 10th, 1938). Nevertheless, because of other unfair acts of the parent, its claim, based solely on admittedly lawful and fair transactions, was subordinated.

Continued Advances by a Parent to a Subsidiary to Pay Simultaneous Dividends to the Parent Cannot Give Rise to a Valid Claim.

$2,795,000† of the MOP Claim is based on sums which MOP, in eleven out of thirteen consecutive quarters, advanced to NOTM. All but $141,000 thereof was returned

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* The Court below speaking through another Judge similarly stated in *In re Kansas City Journal-Post Co.*, 144 F. (2d) 791 (C. C. A. 8th, 1944):

> "The inequity which will entitle a bankruptcy court to regulate the distribution to a creditor, by subordination or other equitable means, need not therefore be specifically related to the creditor's claim, either in its origin or in its acquisition, but it may equally arise out of any unfair act on the part of the creditor, which affects the bankruptcy results to other creditors and so makes it inequitable that he should assert a parity with them in the distribution of the estate; and with the most critical force may the application be made where a fiduciary relation is involved." (144 F. [2d] 791 at 804.)

† Respondents contend that the advances for matching dividends total only $2,082,456. They assert that the MOP advances in November, 1928 and February, 1929, matching simultaneous NOTM advances are not relevant because of NOTM repayment. They also would not include any part of a matching advance in excess of $259,576, the amount of the simultaneous dividend (Group Brief, p. 21n). Respondents, however, overlook the fact that MOP itself dictated the allocation of NOTM repayments among the various MOP advances, and that respondents themselves included—as they had to—such advances in the schedule showing the basis for the MOP Claim (Ex. 239, 281, R. 791, 900).

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to MOP within a few days in matching payments, described as dividends.

Mr. Wyer and respondents seek to dismiss the relation of the eleven advances to eleven dividends as a coincidence (R. 901-903; Group Brief, p. 24). How many times must a coincidence occur before it becomes more than a coincidence?

Whether or not the "purpose" of the borrowing was to reimburse the NOTM treasury for expenditures for improvements, as the District Court found (R. 18), the matching dividends were in fact paid out of the advances.

Without such MOP advances, the NOTM dividends could not have been paid; the NOTM Treasurer did not have the available cash (Ex. 75-79, R. 453).

Respondents concede, in effect, that these advances would not have been necessary if NOTM had not declared dividends to MOP (R. 903; Group Brief, p. 24).

We do not take issue with the cases cited by respondents, dealing with an isolated borrowing by an independent corporation from a third party in order to pay an isolated dividend (Group Brief, p. 46). We contend that such cases have no application to a consistent pattern of repeated simultaneous advances and dividends between parent and subsidiary.

NOTM Dividends 450% of Consolidated Earnings.

After 1926, there was not one year in which NOTM consolidated income covered the dividends exacted, quarter in and quarter out, by MOP. During this period, NOTM dividends of $5,190,000 dwarfed consolidated earnings of $1,150,000 (Ex. 301, R. 914). No independent management would have continued the unbroken chain of dividends in excess of earnings over twenty consecutive quarters. No independent management would have paid such dividends in excess of 450% of earnings.

MOP was subjected to intense pressure—from its continued bond flotations and from its parent, Alleghany—to

maintain its reported income. Receiving over 90% of each NOTM dividend, MOP insisted on a steady flow of dividends, even when "payment" was possible only through simultaneous paper "advances".

Such NOTM dividends were all the more detrimental since "it was apparent", as respondents point out, "that substantial improvements would be necessary in order to make the GCL a first class railroad system" (Group Brief, p. 12). The time when heavy expenditures are being made for such improvements, as well as for expansion, is not the time for dividends, and certainly not for borrowing to pay dividends in excess of earnings.

After years of draining NOTM dividends in excess of earnings, MOP had to resort to extraordinary efforts to continue NOTM dividends in 1931.

It was already the second year of the depression, and the officers of MOP and NOTM knew that 1931 was going to be a bad year * (Ex. 137, R. 601).

To provide NOTM with an ostensible surplus to permit the declaration of such dividends in 1931, MOP caused NOTM's principal subsidiary, the St. Louis, Brownsville & Mexico Ry. Co. (hereinafter called Brownsville) to declare dividends totalling $4,155,000 in the space of less than one month in 1931.

Brownsville could not pay such dividends, as the officers of NOTM knew at the time. Thus, $3,155,000 of these dividends remained unpaid throughout 1931 (Ex. 311, R. 928). Nonetheless, it was all included in NOTM 1931 income.

When the Commission in 1936 directed NOTM to write off all the Brownsville dividends then unpaid, it did not thereby approve that portion of these Brownsville dividends which were paid after 1931, as respondents suggest (Group Brief, p. 31). The Commission expressly stated:

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* There is no basis for respondents' suggestion that the disappearance of earnings was not known until "several months after the end of that year" (Group Brief, p. 56).

> "While it is at this time too late to correct the income accounts which have already been closed, it is not too late to write off the unpaid portion of this dividend * * *" (Ex. 63, R. 421).

Thus, in reconstructing the NOTM 1931 balance sheet in accordance with the decision of the Commission, $3,155,000—unpaid through 1931—must be deducted.* The Commission expressly found that inclusion of the dividends in NOTM income was improper "prior to actual collection" (Ex. 63, R. 421). With such a deduction, NOTM 1931 dividends resulted in an impairment of NOTM capital of $800,000 (Ex. 195, R. 663).

This is what Mr. Wyer meant when he told the Senate Committee that 1931 NOTM dividends were paid out of capital † (R. 296).

Whether or not NOTM dividends in 1931 were illegal is not decisive. As this Court emphasized in the *Deep Rock* case, the test of dividends is whether or not an independent management "with an eye single to" the interests of the subsidiary would have declared them (306 U. S. at 323). These dividends do not meet such a test.

The MOP Claim Includes an Item of $1,261,009 "Saddled" on NOTM Without Authority or Consideration.

The MOP Claim includes a bookkeeping write-up of NOTM indebtedness amounting to $1,261,009 from which NOTM has not received one penny to this day. This was done on the threshold of bankruptcy.

Respondents seek to justify this transaction on several grounds (Group Brief, pp. 25-27).

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* Thus, respondents are in error when they attempt to bolster the 1931 NOTM balance sheet by $1,100,000 of these 1931 Brownsville dividends, paid *after* 1931 (Group Brief, pp. 30-31). (Italics added.)

† *Hearings before Sub-Committee of Senate Committee on Interstate Commerce* pursuant to S. Res. 71, 75th Cong., 1st Sess., Part 12, p. 5296 (1938).

They assert that the debts of the subsidiaries amounting to $1,261,009 * could not have been permitted to remain unpaid. They overlook the fact that a component of the MOP system—not a member of the public—was the creditor.

If MOP had let matters stand as they were, it would have made no difference whatsoever to the debtor companies.

Respondents maintain that NOTM had to acquire these claims to protect its ownership and control of the Gulf Coast Lines. No reason in support of that contention is suggested. The NOTM position already rested on its ownership of all the mortgage bonds of these roads—superior in lien to these unsecured claims. The stock of these roads had for a long time been of dubious value. These roads ran at a deficit, as Mr. Wyer pointed out (R. 873). The road owing most of these claims had been in default to NOTM for years on its mortgage bond interest (Ex. 179, 223, R. 632, 701). NOTM already held over $19,000,000 of past-due indebtedness of its subsidiaries (Ex. 69, 94, R. 432, 486). Consequently, the addition of $1,261,009 in claims constituted no additional protection to NOTM.

Respondents finally seek to defend this transaction as undoing a violation of NOTM's fiduciary obligations to IGN.

MOP concededly dictated the policies of both NOTM and IGN throughout this period. It was MOP, not NOTM, that dictated the substance and form of all these transactions. One instance of MOP wrongdoing may not be justified by another.†

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* The only possible claim that International Great Northern Ry. (hereinafter called I-GN) might have had against NOTM amounted to $64,129 (Ex. 223, R. 701).

† Respondents have suggested that all the facts about the MOP Claim were before the Commission. The record before the Commission will be examined in vain to find the details of this "saddling" transaction. These were not brought out until the presentation of petitioner's case in the hearing in the District Court.

Respondents further assert that the $1,261,009 write-up should be allowed, because, indeed, it did not harm NOTM. This is a remarkable shift from respondents' position that all advances were in cash and that NOTM received a full dollar's worth for each dollar of advances (Group Brief, p. 63).

The Significance of Intra-Gulf Coast Lines Transactions.

Respondents contend that an inquiry into the transactions between NOTM and its subsidiaries at the dictation of MOP is "without significance" and irrelevant (Group Brief, pp. 31-32).

It is settled law, however, as respondents concede, that the legality of NOTM dividends to MOP must be judged by NOTM balance sheets, not by the consolidated balance sheets.

The intra-Gulf Coast Lines transactions are significant because they are the device by which MOP increased NOTM book income and ostensibly permitted NOTM to pay dividends to MOP, which it otherwise could not have paid.*

Acquisition of "Feeder" Lines.

Respondents have recognized in their brief—as did their predecessor committee and the Commission †—that the five Texas "feeder" lines acquired by NOTM at the cost of over five and one-half million dollars had been acquired for the benefit of MOP and IGN.

On page 10 of their brief, they admit that the MOP system received benefits from the traffic of these "feeder" roads, and that adjustments in favor of NOTM were nec-

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* Thus, the role of Brownsville dividends in the scheme of MOP management is clear. As Mr. Baldwin testified: "That was the only way that I knew to pass money" to NOTM (R. 602).

† *Missouri Pacific R. R. Reorganization,* 239 I. C. C. 7, 71 (1940); First Amended Plan of Reorganization, Protective Committee for MOP First and Refunding Bonds, p. 61; R. 20882.

essary. They claim, however, that such adjustments were already made in the allocations of securities in the 1944 Plan—since remanded.

This case, however, is concerned with the validity and priority of the MOP Claim, not with the allocation of all new securities in a Plan of Reorganization.

If MOP management imposed such purchases for its own benefit upon NOTM—as is generally recognized—"any adjustments which need to be made" can, in the first instance, properly be made only through the disallowance or subordination of the MOP Claim.

The Findings of the Commission on the MOP Advances.

This Court has clearly established that the determination of the validity and priority of a claim is a judicial and not a Commission function.* Nevertheless, respondents seek to attribute the "greatest weight" to certain findings by the Commission with respect to the MOP advances (Group Brief, pp. 21-22).

These findings were made in connection with MOP's application for further loans from the RFC (*Missouri Pacific R.R. Reconstruction Loan,* 189 I. C. C. 286 (1933), R. 110-19).

In support of such MOP application, Mr. Wyer submitted sworn financial statements. It was on the basis of such statements that the Commission approved the loan.

Subsequently, the Commission discovered that such financial statements sworn to by Mr. Wyer were "incorrect and misleading". It reported that fact to the Congress (51st Commission Annual Report (1937), pp. 27, 28).

The chief railroad examiner of the RFC stated that it had been on the basis of such sworn papers that the RFC was induced to make the loans to MOP (*Senate Com-*

* *Ecker* v. *Western Pacific R. R.*, 318 U. S. 448, 479 (1943); *American United Mutual Life Ins. Co.* v. *Avon Park*, 311 U. S. 138, 145-46 (1940).

mittee Hearings, supra, 75th Cong., 1st Sess., Part 3, pp. 1111-18, [1938]).

Yet, respondents now seek to attribute validity and priority to the MOP Claim by reference to *ex parte* Commission findings induced by such misrepresentations.

The *Deep Rock* Case.

Several statements of respondents with respect to the *Deep Rock* case should not go uncorrected (Group Brief, pp. 43-46).

Respondents stress the place that the Bradstreet property transaction played in the decision of the Court. Although this was an important instance of Standard mismanagement, it was not the decisive feature in the case.*

The continued payment of dividends out of borrowed funds when Deep Rock was already borrowing for other purposes, and the failure to provide Deep Rock with resources adequate for the conduct of its business, not the Bradstreet transaction, occupied the leading role.

This Court left no doubt that subordination was ordered because the "fiscal affairs" of Deep Rock had not "been conducted with an eye single to its own interests" (306 U. S. at 323).

Respondents have misconceived the meaning of inadequate capitalization. They assert that adequacy of capitalization of a subsidiary is tested solely by the sufficiency of the parent's investment in the stock through which it exercises control (Group Brief, p. 49). They stress the amount of total GCL assets. Such assets, however, did not relieve either NOTM or its subsidiaries from the constant necessity of borrowing millions and millions of dollars throughout the period of MOP control. Nor did such assets suffice to stave off bankruptcy.

To avoid inadequacy of capitalization, the subsidiary must be capitalized at a level which provides it with suf-

* In its discussion of the salient facts of the *Deep Rock* case, the Court in the *Commonwealth* case did not think the Bradstreet transaction sufficiently important to warrant mentioning.

ficient funds to conduct its business. Thus, where the debt of the subsidiary steadily increases and where it is forced to borrow continually, in good years and bad, to carry out a program dictated by the parent, it is inadequately capitalized. This is what this Court had in mind when it criticized the inadequate capitalization of Deep Rock (306 U. S. at 315).

Respondents point out, in another connection, that the parent "could have made additional investments in the capital stock of the subsidiaries * * * to finance improvements" (Group Brief, p. 28). This is precisely what MOP should have done with NOTM. Its failure to do so is one of the compelling reasons for subordination of the MOP Claim.

An independent board managing NOTM would either not have embarked on such an expansion and improvement program, or, if it had, it would have financed it, not solely through borrowing, but with new equity money.

Respondents defend the lack of additional equity investment on the ground that the Commission authorized the issuance of certain bonds to finance a portion of the expansion and improvement program (Group Brief, p. 52). The Commission, however, was not considering the significance in a bankruptcy proceeding of such bond issues in the light of the entire financial and dividend program imposed on NOTM during this entire period. The Commission, in passing on the legality of a bond issue in 1925 or 1927, was not passing on the priority of subsequent NOTM advances under the rule of the *Deep Rock* case.

The doctrine of subordination is not limited to preventing intentional preferences, as respondents suggest (Group Brief, p. 50). There is no basis for such restriction. When a parent advances sums to a dominated subsidiary, whose resources are inadequate to enable it to carry on its business and finance expansion, the doctrine of subordination protects public investors, if bankruptcy or reorganization intervenes. The doctrine will not permit the parent—irre-

spective of its intentions—to acquire a prior claim against the subsidiary by denominating such sums as "advances" or "debt" rather than as additional capital investment.

The Courts will not permit bankruptcy results to be determined by the label which the parent—in unrestrained control of the situation—chooses to affix to the transaction.

The *Commonwealth* Case.

Respondents seek to dispose of the *Commonwealth* case by emphasizing the initial capitalization of Michigan, the subsidiary (Group Brief, p. 45). Respondents, however, do not point out that Michigan—unlike Inland (its parent) and MOP and NOTM—never went into reorganization. Whatever one may say about such initial capitalization, it was obviously sufficient to avoid bankruptcy.

Respondents do not discuss the other aspects of the *Commonwealth* case in which the very techniques of MOP mismanagement in issue appear with surprising duplication of detail.

Thus, in both cases, the parents—under holding company pressure—caused the subsidiaries from 1929 through 1931 repeatedly to pay them dividends out of sums simultaneously advanced by them.

Similarly, both subsidiaries, NOTM and Michigan, were compelled to continue to pay such dividends while they were already borrowing for expansion and other purposes.

The doctrine of the *Commonwealth* case and our position are not flatly that "a corporation borrowing to finance an expansion program may not pay dividends", as respondents suggest (Group Brief, p. 47).

The doctrine is that a subsidiary borrowing from its parent to finance an expansion program may not further borrow consistently from the parent to pay it dividends, and particularly to pay it dividends in excess of earnings.

The Presence of MOP Creditors Asserting the Claim Cannot Prevent Subordination.

Respondents urge that the balance of equities is in favor of MOP creditors and that therefore subordination should not be decreed (Group Brief, p. 61).

There is a claim in issue before this Court. If the claim is tainted—if it is invalid or inequitable—it cannot survive, irrespective of the innocence of the persons who may be asserting it.

Respondents concede that the position of MOP creditors cannot purify a tainted claim. They admit:

> "If a claim against a subsidiary is defective or its priority was obtained in breach of a fiduciary duty, disallowance or adjustment of priority would seem to be appropriate * * *" (Group Brief, p. 62).

MOP creditors are thus not in a superior position as to the $2,795,000 of advances of which $2,654,000 was returned to MOP almost simultaneously in dividends.

There can be no superior equities of the MOP creditors for the $1,261,000 "saddling" transaction. This was not an advance, cash or otherwise, and NOTM received no conceivable benefit therefrom.

Respondents urge, however, that advances from MOP in the years 1932 and 1933 were for the benefit of NOTM and that it would have been improper to use MOP funds as a capital contribution to NOTM. They disregard the fact that NOTM's needs for funds during 1932 and 1933 were the direct product of MOP mismanagement throughout its period of control. This contention of respondents relates, moreover, to only $2,230,000 * of the MOP Claim. Whatever its merits, it cannot affect the determination with respect to the overwhelming bulk of the Claim.

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* This figure does not include the $1,261,009 October, 1932 "saddling" transaction, which does not represent any advance by MOP during 1932, and is a "defective" component of the Claim.

Over 38% of the Claim clearly rests on invalid and inequitable items. In the circumstances, this Court will not attempt to separate the components of the Claim and recast or reconstruct the subsidiary's financial position to determine what would have been the case, if the subsidiary had been managed by an independent Board.

The contention of competing equities derives from a misconception of the underlying basis of the *Deep Rock* doctrine. Under circumstances such as in the case at bar, a detailed analysis and specification and measuring of injuries and balancing of equities will not be made. For it is impossible to reconstruct the situation. An attempt to do so is fraught with so many difficulties that it may defeat the salutary purposes of the doctrine. That is why the *Deep Rock* rule is not based on meticulously analyzing isolated acts and weighing the injuries resulting from subserviency of dominated subsidiaries. In short, it is a rule to enforce proper standards of business conduct by fiduciary parents.

To hold otherwise and permit the *Deep Rock* doctrine to be whittled down would speedily mean its destruction as an effective standard for business management.

Respondents also assert that the equities are in favor of MOP creditors because petitioner and other 5¼% Secured Bondholders are secured by a "junior security" and "accepted the risks inherent in such a security" (Group Brief, p. 63). This can in no way excuse any violation of MOP's conceded fiduciary obligations. It is not the law that public investors in a subsidiary are required to accept the risks of a parent's wrongdoing.

MOP's creditors cannot rise above the equities of NOTM. The Claim is an asset of the MOP estate to which the creditors succeed. They succeed to the rights of the parent and no more.

Respondents have conceded that this is the general rule (Group Brief, p. 62). They have failed to demonstrate that it should not be applied herein.

POINT III

The rights of MOP 5¼% Secured Bondholders are unaffected by MOP's transfer to RFC and RCC of two NOTM notes. The rights of the RFC and RCC have been extinguished.

The District Court found that the Reconstruction Finance Corporation and Railroad Credit Corporation * (hereinafter called RFC and RCC, respectively) were bona fide pledgees for value of two NOTM notes representing the bulk of the Claim (R. 19-21). This pledge was subsequently redeemed (R. 1155, 1164). Respondents contend that such one-time transfer to RFC and RCC cut off the equities of the 5¼% Secured Bondholders on this part of the Claim (Group Brief, pp. 34-42). We submit that this contention is without merit.

(a) A determination of the MOP Claim is admittedly necessary to the extent of over $1,000,000.

As the District Court found, $610,000 principal amount of the MOP Claim was never pledged (R. 19-21).

Thus, whatever the consequences of the one-time pledge, an adjudication of that portion of the MOP Claim which was never pledged—amounting with interest to more than $1,000,000—cannot be avoided.

Respondents so concede (Group Brief, p. 42).

* The RCC held a second lien on the NOTM notes held by the RFC.

(b) The rights of the RFC and the RCC in the NOTM notes have become moot. What classes, if any, of MOP creditors succeed to the rights of the RFC and RCC has not yet been determined.

Several months after the order in issue adjudicating the MOP Claim, the District Court authorized the Trustee of MOP to purchase and settle the RFC and the RCC Claims (R. 1155, 1164). The RFC and the RCC surrendered their claims, together with all collateral, including the NOTM notes, to the Trustee of MOP.*

The findings of fact and conclusions of law of the District Court relating to the RFC and the RCC (R. 19-21, 30-2) have thus become moot. This was impliedly recognized by the Court below.

The orders of the District Court do not subrogate respondents or any other class of MOP creditors to the rights of the RFC and RCC. These orders do not determine the equitable owners of the cash in the MOP estate used in the settlement of the RFC and RCC Claims—the only basis for subrogation. This question was expressly reserved for future adjudication.† Such a determination of fact obviously cannot be undertaken by this Court.

(c) MOP, as claimant, always remained subject to the rights of MOP 5¼% Secured Bondholders.

Irrespective of any alleged consequences flowing from the pledge of the two NOTM notes, MOP—the payee in the notes and the claimant herein—at all times remained subject to the rights of MOP 5¼% Secured Bondholders.

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* The RFC was then stricken as a party herein (R. 1348). The RCC never was a party (R. 369-70).

† The orders specify "to the extent of their * * * interests, *if any*" (R. 1157, 1165). (Italics added.)

A wrongdoing payee may subject a maker of a note to liability by negotiating it to a holder in due course. Although such holder receives perfect title, such transfer does not protect the wrongdoing payee.

As between the maker (NOTM) and the payee (MOP), all questions with regard to the transactions surrounding issuance of the notes remain open for determination, irrespective of negotiation subjecting the maker to liability to a holder.

Metropolitan Elevated Ry. v. *Kneeland,* 120 N. Y. 134, 24 N. E. 381 (1890).
Gates v. *Ritchie,* 162 Ark. 484, 258 S. W. 397 (1924).
Bourke v. *Spaight,* 80 Kan. 387, 102 Pac. 253 (1909).

Whatever the rights of the RFC and RCC on these notes, MOP, the claimant, has always remained subject to the rights of NOTM.

(d) The NOTM notes have been reacquired by the payee-claimant; NOTM defenses are not cut off.

The RFC and RCC have surrendered the NOTM notes. Said notes are again in the possession of the payee, MOP, through its Trustee.

It is settled law that a wrongdoing payee reacquiring an instrument—even from a holder in due course—is subject to all the equities and defenses of the maker.

*Uniform Negotiable Instruments Law,** Sec. 58.
Collis v. *Kraft,* 118 Kan. 531, 235 Pac. 862 (1925).

Even if the District Court should subsequently rule that any class of MOP creditors has a lien on the notes held

* The *Uniform Negotiable Instruments Law* is in force in both Missouri and Ohio.

by the reacquiring payee, through its Trustee, such lien would be an equitable lien.*

Such equitable lien, however, can give MOP creditors no better rights against NOTM than those of the payee, MOP. Moreover, the NOTM equitable defenses arose first and must prevail.

Respondents also argue that as a result of the orders on the RFC and RCC claims, the MOP creditors claiming rights by way of subrogation "acquired perfect title" to the NOTM notes under said Section 58 (Group Brief, p. 41).

This contention is erroneous. As we have seen, there has been no determination as to what class of MOP creditors, if any, is entitled to subrogation. Moreover, Section 58 extends only to holders. Under Section 191 such creditors are not holders since they are not in possession of the notes. The holder is the Trustee of the reacquiring wrongdoing payee, barred from the protection of Section 58.

(e) The doctrine of marshalling protects MOP 5¼% Secured Bondholders.

The bankruptcy doctrine of marshalling of assets also protects the equities of MOP 5¼% Secured Bondholders. Assets must be marshalled where a creditor holds the obligations of two debtors, one of which is entitled to be reimbursed by the other. Under such circumstances the common creditor is required to proceed first against the assets of the wrongdoing debtor. This was long ago settled.

Ex parte Kendall, 1 Rose 71, 17 Ves. Jr. 514 (1811).
Tower Grove Bank & T. Co. v. *Duing,* 346 Mo. 896, 903, 144 S. W. (2d) 69 (1940).

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* Respondents concede that their alleged interest in the cash used by the Trustee—the alleged basis for subordination—was only an equitable lien (Group Brief, p. 40).

The RFC and RCC were secured by a large amount of MOP collateral, other than the NOTM notes (R. 1185, 1187). Under the doctrine of marshalling, the RFC and RCC would have been first required to apply the other MOP collateral to the satisfaction of their claims. Recourse to the NOTM notes would be permissible only if such other collateral proved insufficient.

Such other collateral was more than sufficient.* The District Court, on testimony ascribing *no* value to the NOTM notes (R. 1178), accordingly found:†

> "That the fair market value of the collateral pledged as security for said (RFC) claim is substantially in excess of the amount proposed to be paid RFC in compromise and settlement of its claim" (R. 1156).

Respondents argue that the market value of such collateral is of little importance for valuation purposes, and that earning power is critical.‡

In the *New Haven* reorganization, the Second Circuit held that market value is the measure of valuation of freely traded securities. The Court expressly held that

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* It included securities actively traded on the New York Stock Exchange with a market value of over $41,500,000 in contrast to the $26,033,000 for which the RFC Claim was settled (R. 1178, 1185).

† An identical finding was made with respect to the RCC (R. 1164).

‡ Respondents cite the last paragraph of Section 77(e), the *Ecker* and *Milwaukee* cases, and a recent Second Circuit decision in the *New Haven* reorganization.

None of these relates to the basis for valuation of securities freely traded on the market. The reference to earnings in the last paragraph of Section 77(e), for example, is expressly limited to the valuation of "property used in railroad operation".

the earnings of the properties underlying such securities were of no importance.*

In re New York, N. H. & H. R. R., 147 F. (2d) 40, 47-48 (C. C. A. 2nd, 1945), *cert. denied*, 325 U. S. 884 (1945), *reh. denied*, 326 U. S. 805 (1945).

Respondents maintain, furthermore, that marshalling is controlled not by this recent valuation of the District Court, but by a 1944 Commission valuation (R. 20762) (Group Brief, pp. 36-7).

When the District Court, however, found that the value of the RFC and RCC collateral (other than the NOTM notes) was substantially in excess of the loans, it was necessarily finding that the 1944 Commission valuation was then out of date. This subsequent adjudication must control.

Respondents seek to claim benefits under the orders relating to the RFC and RCC Claims but refuse to accept the valuation finding on which the orders were based. If respondents claim to have the right to be subrogated under such orders, they must concede that such other RFC and RCC collateral substantially exceeded the loans, with its corollary that marshalling is required herein.

POINT IV

The MOP Claim must be adjudicated on the merits. The Court below so ruled.

Neither petitioner nor other public holders of MOP 5¼% Secured Bonds are barred by laches.

Respondents' contention that laches is applicable because of the death of several possible witnesses is incongruous

* The recent *New Haven* decision cited by respondents involves marketable securities, but does not involve the measure of valuation. The doctrine of the earlier decision cited in the text is not questioned in any way. *Old Colony Bondholders* v. *New York, N. H. & H. R. R.*, 161 F. (2d) 413, 419-422 (C. C. A. 2nd, 1947), *cert. denied* 331 U. S. 858 (1947).

in the face of the record of many volumes, which the two Courts below felt more than adequate for an adjudication on the merits of the MOP Claim.

There are further incongruities in respondents' contention. Laches is not invoked by petitioner defending NOTM against its fiduciary parent's claim. It is not invoked by the fiduciary claimant or its Trustee. It is invoked by a number of bondholders of the claimant who have conceded that they lack any "financial interest" in the Claim (Group Brief, Dist. Ct., p. 2).

(a) An adjudication of the MOP Claim is indispensable for reorganization.

An adjudication on the merits of the validity and priority of the MOP Claim is indispensable for the purposes of the reorganization.

> *Ecker* v. *Western Pacific R. R.*, 318 U. S. 448, 479 (1943).
> *American United Mutual Life Ins. Co.* v. *Avon Park*, 311 U. S. 138, 145 (1940).

Without such an adjudication the reorganization cannot be completed. The reorganization court will be unable to make the finding required for approval of any plan of reorganization—that it is fair and equitable.

The Circuit Court indicated in its opinion that the doctrine of laches accordingly cannot be invoked to prevent an adjudication of the Claim (R. IV, 20-1).

(b) Laches may not be invoked since the Claimant could have moved for allowance of its Claim.

The MOP Claim resting on transactions between a fiduciary parent and its controlled and dominated subsidiary was "presumptively fraudulent" and required "rigorous scrutiny" before allowance.

Corsicana National Bank v. *Johnson*, 251 U. S. 68, 90 (1919).

Pepper v. *Litton*, 308 U. S. 295, 306-307 (1939).

Furthermore, the petitions filed in the District Court by the NOTM Bondholders Committee and Indenture Trustee, and still pending, had put the fiduciary claimant on notice that its claim was subject to question (R. 87, 101, 109).

The fiduciary claimant, MOP, through its trustee, could have requested the Court to determine the validity of its presumptively suspect claim at any time.

For its failure to do so, it has only itself to blame and cannot complain.

Cf. *Dudley* v. *Mealey*, 147 F. (2d) 268 (C. C. A. 2nd, 1945), *cert. denied*, 325 U. S. 873 (1945).

As Judge Learned Hand said in *Dudley* v. *Mealey*, a case involving a fiduciary claimant:

> "It would have been quick and cheap to obtain a ruling from the court upon the propriety of the * * * (fiduciary's claim); there was no need to wait until the Plan came up for approval; for any prejudice that may now result from the delay the parties (pressing the claim) have themselves to thank" (147 F. (2d) at 272).

Where a party might himself have moved for a judicial determination of the issue in dispute, and has failed to do so, he may not invoke laches.

Rannels v. *Rowe*, 145 Fed. 296 (C. C. A. 8th, 1906), *cert. denied sub nom. Sharpe* v. *Rannels*, 207 U. S. 592 (1907).

Spiller v. *St. Louis & S. F. R. R.*, 14 F. (2d) 284, 288-289 (C. C. A. 8th, 1926), *aff'd on laches issue, rev'd in part*, 274 U. S. 304 (1927).

Faced with a "presumptively fraudulent" claim of a fiduciary parent against a subsidiary, deprived of the pro-

tection of an independent trustee, it was the duty of the District Court, *sua sponte*, to adjudicate the claim.

Cf. *Dudley* v. *Mealey*, 147 F. (2d) 268 (C. C. A. 2nd, 1945), *cert. denied*, 325 U. S. 873 (1945).
3 *Collier, Bankruptcy* (14th ed.), pp. 216-17.

Such duty on the District Court was emphasized by the attack on the character of MOP management of NOTM in the petitions filed by the NOTM Bondholders Committee and Indenture Trustee (R. 87, 101).

The disposition of a parallel problem by the Circuit Court of Appeals for the Second Circuit in *Dudley* v. *Mealey, supra*, is pertinent.

In that case, Judge Learned Hand, speaking for the Court, condemned a Plan permitting a trustee to profit by its breach of fiduciary loyalty.

He stated that this was a matter "such that the judge might, and perhaps should, have taken notice * * * *sua sponte*". Judge Hand emphasized the Court's duty by directing it to "itself conduct the inquiry into the conduct of the * * * [Trustee, if the single isolated objector] should default" (147 F. (2d) at 270, 273).

In no event is laches applicable herein. The doctrine consists of two essential elements: lack of timeliness and prejudice. Neither element is present.

(c) Petitioner's objections were timely.

The order in issue of the District Court below was the first order of allowance of the MOP Claim. That the MOP Claim had not previously been allowed is clear from the form of such order which concluded that the MOP Claim "should be allowed" (R. 31). The Circuit Court below similarly recognized that not until the District Court order below had there ever been a "judicial determination upon the validity of the" MOP Claim (R. IV, 20-1). It affirmed, holding that "the claim of Missouri Pacific was properly allowed" (R. IV, 27).

(1) *Objections to a claim are timely before allowance.*

Allowance of a claim does not arise automatically from the filing of the proof of claim. A judicial order of allowance is necessary. Until such order, objections to the claim are timely.

In re Two Rivers Woodenware Co., 199 Fed. 877 (C. C. A. 7th, 1912).
In re Branner, 9 F. (2d) 883 (C. C. A. 2nd, 1925).
In re Tower Magazines, Inc., 16 F. Supp. 894 (M. D. Pa., 1936).

The two cases * cited by respondents for the proposition that laches may bar objections to a claim are not in point (Group Brief, p. 70). They relate to *allowed* claims, with a definitely established prejudicial change of position following upon allowance.

Such decisions have no relevance to the instant case involving the first judicial determination of a claim.

Petitioner was timely under the orders of the District Court as well.

Order No. 19 of the District Court prescribed the procedure for filing objections to claims in these proceedings. Such orders provided that the objections might be filed within the time fixed by the Special Master (R. 72). No limit has ever been fixed either by the Court or Special Master; † the time for filing has not expired.

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* *In re American S. S. Nav. Co.*, 14 F. Supp. 106 (E. D. Pa., 1933), aff'd sub nom. *Cooper* v. *Rauch*, 82 F. (2d) 1005 (C. C. A. 3rd, 1936); *In re Nichols*, 166 Fed. 603 (N. D. N. Y., 1909).

† Other claims against the debtors in the instant proceedings were still undisposed of at the time of the hearings in the Court below (R. 257). The Special Master has died, and no successor has been appointed.

(2) *Objections to a claim may be made after allowance in the absence of a prejudicial change of position.*

Even if the MOP Claim be viewed as an allowed claim —a point of view which cannot be sustained—laches cannot apply.

Allowance of a claim, of itself, does not bar objections. Thus, order No. 235 of the District Court expressly established a procedure with respect to objections to allowed claims (R. 79). No time limit for filing such objections has ever been fixed.

Laches may be invoked to bar such objections only if allowance of a claim is followed by a prejudicial change in position.

Without prejudice, allowed claims may be reconsidered until the close of the estate.

> Section 57k, National Bankruptcy Act.
> Section 2a(2), National Bankruptcy Act.

Respondents, however, contend that Section 57k is inapplicable to the instant case (Group Brief, p. 79). At one point, they appear to say that Section 57k does not apply to Section 77. There is, however, no support for such a suggestion. Cf. *In re Denver & R. G. W. R. R.*, 27 F. Supp. 983 (D. Col., 1939); *National City Bank* v. *O'Connell*, 155 F. (2d) 329, 332 (C. C. A. 2nd, 1946).

Elsewhere, respondents appear to indicate that Section 57k cannot be applied because of petitioner's "dilatory conduct". Laches, however, is a question of prejudice as well as of delay.

Respondents, moreover, ignore Section 2a of the Bankruptcy Act, which this Court has held to be applicable to Section 77.

> *Continental Illinois N. B. & T. Co.* v. *Chicago, R. I., & P. R. R.*, 294 U. S. 648, 675-6 (1935) (Sec. 2a(15) case).

(d) There was no prejudice.

The mere lapse of time is insufficient to justify the application of laches. The lack of timeliness, if any, must be prejudicial.

Northern Pacific R. R. v. *Boyd*, 228 U. S. 482, 509 (1913).

Penn. Mutual Life Ins. Co. v. *Austin*, 168 U. S. 685, 698 (1898).

As this court said in the *Penn. Mutual Life Ins.* case:

> "The reason upon which the rule (of laches) is based is not alone the lapse of time during which the neglect to enforce the right has existed, but the changes of condition which may have arisen during the period in which there has been neglect. In other words, where a court of equity finds that the position of the parties has so changed that equitable relief cannot be afforded without doing injustice or that the intervening rights of third persons may be destroyed or seriously impaired, it will not exert its equitable powers in order to save one from the consequences of his own neglect" (168 U. S. at 698).

Respondents have failed to demonstrate such injustice or change of position. Relying solely on the testimony of one witness—Mr. Railey—they contend that they have been prejudiced in only one respect: the presentation of the case in support of the MOP Claim. (R. 191-207, 744-62; Ex. 360-2) (Group Brief, pp. 67-71).

It is argued that records have been destroyed (Group Brief, p. 70). The District Court did not so find (R. 28). Mr. Railey was asked whether "all the records and books of account giving rise to * * * (the MOP) claim are available at the present time". He answered in the affirmative (R. 197, 203).

The only other basis of prejudice alleged by respondents is the death of several possible witnesses.

The death of material witnesses, or even of parties, does not of itself constitute sufficient prejudice to invoke laches.

Laches may be applied only if the death of such witnesses makes so much testimony unavailable that the Court is precluded from reaching a "safe" conclusion.

Bickel v. *Argyle Inv. Co.*, 343 Mo. 456, 121 S. W. (2d) 803, 807 (1938).

Consolidated Placers, Inc. v. *Grant*, 48 N. Mex. 340, 349, 151 P. (2d) 48, 54 (1944).

Shirley v. *Van Every*, 159 Va. 762, 167 S. E. 345 (1933).

Wood v. *Sanders*, 247 Ala. 492, 496, 25 So. (2d) 141 (1946).

Petitioner's case rests primarily on documentary evidence. These include corporate records, balance sheets, books of account, minutes and official reports submitted to the Commission. Consequently, the facts in this case are almost entirely undisputed, despite the size of the Record.

The District Court did not find the many hundred pages of testimony and the 180 exhibits in the Record insufficient to reach a "safe" conclusion. On the contrary, the District Court termed the evidence "extensive" and "voluminous" and adjudicated the MOP Claim on the merits (R. 1109). Its detailed findings of fact on the merits cover seventeen pages of the Record (R. 8-25).

After rejecting the contention of laches, the Circuit Court also adjudicated the claim on the merits. Thus, the Courts below unmistakeably demonstrated that the wealth of evidence before them was adequate for a "safe" adjudication on the merits.

This action of the Courts below disposes of the contention of laches.

The conduct of respondents themselves fortifies the conclusion that laches is inapplicable. Respondents have never suggested that the evidence is insufficient.* The

* Respondents themselves asserted in the Court below: "It is only reasonable to presume that all of the available facts relating to the intercompany claim are in the record" (Group Brief, C. C. A., p. 76).

number and character of the witnesses testifying for them in the District Court and respondents' decision not to call numerous other available witnesses affirmatively demonstrate that the death of a few possible witnesses caused no gaps in the testimony.

Respondents' main witness was Mr. William Wyer, Treasurer of MOP and NOTM and the architect of most of the transactions complained of. With his testimony covering 142 pages in the record, Mr. Wyer, testified in detail on MOP and NOTM financial affairs dating as far back as 1917 (R. 867-933, 960-1016, 1018-38).

There was hardly anything of a financial nature to which he did not testify. He even testified that he knew what was in the minds of MOP and NOTM directors, what information they looked at, and what governed their decisions (R. 985, 892, 912).

The District Court found:

> "He probably knows as well as anybody what was going on. * * * He was in touch with everything that was going on * * * " (R. 882).

Further detailed testimony on financial matters was given by Mr. Martin Eckert, general auditor after 1918 of NOTM, Brownsville and Beaumont. Mr. Eckert, whose testimony occupies almost 200 pages of the Record, testified that he had general supervision of the accounts and ledgers of these roads, as well as the reports submitted to the Commission, during the entire period of MOP control (R. 496-571, 629-37, 660-738, 790-814, 1040-61).*

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* Other financial witnesses included Mr. Amos T. Cole, Treasurer and/or Assistant Secretary of NOTM from 1923 to 1933, Assistant Secretary of MOP in 1932, and occupying similar offices in NOTM subsidiaries throughout this period (Ex. 4-58; R. 403-406, 571-89). Another was Mr. Edwin Wagner, Assistant Secretary and Assistant Treasurer of NOTM and subsidiaries after 1926 (R. 589-95).

Nor was testimony received on financial matters alone. Messrs. Kirkpatrick, Rodgers, Brown and Bradley—men with up to thirty and forty years' experience with these roads—testified in detail on the physical condition and operations of MOP and NOTM, as far back as 1907 (R. 814-67, 933-60, 1016-18).

In addition, numerous other officers of MOP, NOTM and NOTM subsidiaries—participants in the transactions in issue—were available. The failure of respondents to call them can only mean that respondents did not believe that further testimony was necessary.

1. Mr. L. W. Baldwin had been President of MOP, NOTM and NOTM subsidiaries throughout this period. Petitioner called Mr. Baldwin to the stand. Respondents did not cross-examine Mr. Baldwin, nor call him subsequently as their own witness (R. 596-608). They assert that they did not want to divert Mr. Baldwin's attention to these matters during the War (Group Brief, p. 70). This is a bit disingenuous. They forget that Mr. Baldwin was an interested spectator during the course of the District Court hearings (R. 606).

If Mr. Baldwin could not have added to respondents' case, what could have been added by those of his subordinates who had died? There has been no suggestion that they knew more about it than he.

2. Mr. W. G. Vollmer had been assistant to Mr. Baldwin. His hand appears in many transactions. His name and initials appear on many of the letters introduced by petitioner relating to NOTM and Brownsville dividends (Ex. 125-31, 137, R. 600-1). Mr. Vollmer was present in the District Court (R. 653). Yet, he was not called by respondents.

3. Mr. Leonard P. Ayres, a member of the MOP and NOTM Executive Committees, was also present in the District Court (Ex. 33-58, R. 406). Mr. Ayres was very close to Mr. O. P. Van Sweringen, Chairman of the Board of MOP and NOTM, lunched with him daily, and knew his plans (*Senate Committee Hearings, supra,* 75th Cong., 1st Sess., Part 12, pp. 5209, 5431 (1938)). Respondents did not put Mr. Ayres on the witness stand.

4. Mr. Herbert Fitzpatrick had been Vice-President of MOP, NOTM, Brownsville and Beaumont (Ex. 39-61, R. 406). Mr. Wyer described him as the close friend and advisor of Mr. Van Sweringen (*Senate Committee Hearings, supra,* 74th Cong., 2nd Sess., Part 2, p. 582 [1938]). Mr. Fitzpatrick had undertaken to get Commission approval of MOP's applications to borrow from RFC, and of NOTM's application to issue one of the pledged notes (*Missouri Pacific R. R. Reconstruction Loan,* 189 I. C. C. 286, 342, 549; *New Orleans, T. & M. Ry. Notes,* 189 I. C. C. 600 [1933]). Respondents did not call Mr. Fitzpatrick.

Respondents, disregarding such available witnesses, complain of the death of others.

1. Thus, respondents point to the death of Mr. Safford, Vice-President of MOP and NOTM (Group Brief, pp. 67-68). Mr. Baldwin, who gave Mr. Safford his orders, was present in court. Mr. Railey admitted that Mr. Eckert had full knowledge of all the financial and auditing matters and that assistants to Mr. Safford were living (R. 756-757; R. 203). Respondents did not call any of them.

2. Another person whose death is complained of is another MOP and NOTM Vice-President, Mr. F. P. Johnson (Group Brief, p. 68). Respondents assert that Mr. Baldwin relied on Mr. Johnson for "information and advice". Respondents did not call Mr. Baldwin. Yet, they seek now to ascribe importance to Mr. Johnson because of his relationship to Mr. Baldwin. Secondly, respondents state that several letters with respect to NOTM dividends contained Mr. Johnson's initials. Mr. Baldwin's and Mr. Vollmer's initials and names appear on even more letters of that general character. Yet, respondents did not call either.

3. Respondents also complain of the death of Mr. O. P. Van Sweringen. They ignore the fact that Mr. Wyer, who testified at great length, had been Mr. Van Sweringen's assistant. Moreover, Mr. Ayres and Mr. Fitzpatrick, close associates of Mr. Van Sweringen, were available, but respondents failed to call them.

4. The death of Mr. Frank Andrews * is complained of. Mr. Andrews, however, was only one of "the lawyers and auditing department (to whom the MOP and NOTM Boards left it) to see that dividends * * * conformed with the requirements of the law" (Group Brief, pp. 32-33). The men who gave Mr. Andrews his orders, such as Mr. Baldwin, were available. The head of the auditing department, Mr. Eckert, testified at length. What could Mr. Andrews have added to these?

5. The death of Mr. E. J. White is complained of as well. Mr. Railey conceded that the knowledge of Mr. White was "rather restricted" (R. 760). Moreover, Mr. White's assistant from 1915 until bankruptcy was available; this assistant was none other than Mr. Railey, himself (R. 191).

Thus, respondents' own conduct of the trial demonstrates that the death of several witnesses did not interfere with the effective presentation of their case.

Laches accordingly can have no application herein.

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* Members of the firm of the general counsel of NOTM during the period of MOP control were not only available at the hearings, but were and are counsel for one of the respondents herein—the NOTM Bondholders Committee. Respondents did not call them.

POINT V

Petitioner's personal status does not prevent disallowance or subordination of the MOP Claim.

That petitioner's securities were acquired after bankruptcy at a discount does not place him beyond the pale of judicial protection.

There is no doctrine of law or equity which restricts the free marketability of securities of a corporation in reorganization. Throughout the period since bankruptcy, there has been a substantial turnover in MOP securities. Such subsequent purchasers acquire the rights of their assignors.

Cf. *Wade* v. *Chicago, S. P. St. L. R. R.*, 149 U. S. 327, 343 (1893).

In re Comstock, 154 Fed. 747 (D. R. I., 1907).

In re H. E. Page Motor Car Co., 251 Fed. 318 (D. Mass., 1918).

The personal status of an individual creditor is of little legal significance. Subordination of the MOP Claim will not benefit petitioner alone. It will benefit each and every publicly held MOP 5¼% Secured Bond in equal measure. The interest of an entire class of creditors is at stake.

In fact, the personal status of petitioner is unassailable. There has been no suggestion of fraud, bad faith or other misconduct on the part of petitioner.

Under such circumstances, no less than six different Circuit Courts of Appeal have rejected the contention that a creditor's purchase of bonds at less than face value during, or immediately before, reorganization, has any significance whatsoever with respect to his participation in the reorganization.

In re Pittsburgh Railways Co., 159 F. (2d) 630, 633 (C. C. A. 3rd, 1946), *cert. denied*, 331 U. S. 819 (1947).

Standard Gas & Electric Co. v. *Deep Rock Oil Corp.*, 117 F. (2d) 615, 619 (C. C. A. 10th, 1941), *cert. denied*, 313 U. S. 564 (1941).

In re Consolidated Rock Products Co., 114 F. (2d) 102, 107 (C. C. A. 9th, 1940), aff'd sub nom. *Consolidated Rock Products* v. *DuBois*, 312 U. S. 510 (1941).

Mokava Corp. v. *Dolan*, 147 F. (2d) 340, 344, 345 (C. C. A. 2nd, 1945).

In re Lorraine Castle Apartments Bldg. Corp., Inc., 149 F. (2d) 55 (C. C. A. 7th, 1945), *cert. denied*, 326 U. S. 728 (1945).

Texas Hotel Securities Corp. v. *Waco Development Co.*, 87 F. (2d) 395 (C. C. A. 5th, 1936), *cert. denied*, sub nom. *Waco Development Co.* v. *Rupe*, 300 U. S. 679 (1937).

Not merely one bondholder—but a substantial group—has joined in protecting the NOTM estate against the MOP Claim. Petitioner is also the representative of holders of over $900,000 principal amount of MOP 5¼% Secured Bonds (R. 227). Petitioner's objections to the MOP Claim have further been adopted by the Missouri Pacific R. R. Co. 5¼% Serial Bondholders Committee holding an additional $315,000 principal amount. (*Interstate Commerce Commission Report*, October 15, 1947, pp. 2-3.) This amounts to about 11½% of such bonds publicly outstanding.

As a matter of law, it is settled that the number of public investors who have taken upon themselves the burden of opposing the MOP Claim has no bearing in the case at bar.

Case v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, 114-15 (1939) (holder of $18,500 of $2,565,000 bonds outstanding was the sole objector).

Dudley v. *Mealey*, 147 F. (2d) 268 (C. C. A. 2d, 1945), *cert. denied*, 325 U. S. 873 (1945) (holder of $1,000 of $1,120,000 bonds outstanding was the sole objector).

Controversies involving fiduciary claimants involve such fundamental principles of bankruptcy administration that there is a duty on the Court to act irrespective of the status or number of objectors.

POINT VI

The orders of the Courts below constitute the first adjudication of the MOP Claim. The District Court order on the 1940 Plan has no effect herein.

Respondents now argue for the first time that, since the invalidity or subordination of the MOP Claim might have been raised in connection with the 1940 Plan, the order of the District Court approving that Plan is final and conclusive with respect to these matters (Group Brief, p. 77).

In support of their contention, respondents cite cases involving the doctrine of *res judicata*.

These cases are not in point, since they were concerned solely with the effect to be given to final judgments.

The order on the 1940 Plan is not a final judgment, since it was rendered nugatory by the subsequent action of the Circuit Court in remanding the proceeding.*

In re Pennsylvania Central Brewing Co., 135 F. (2d) 60 (C. C. A. 3rd, 1943).

Leader v. *Apex Hosiery Co.*, 108 F. (2d) 71 (C. C. A. 3rd, 1939), *aff'd* 310 U. S. 469 (1940).

Bucher v. *Cheshire Railroad Co.*, 125 U. S. 555 (1888).

2 *Freeman on Judgments* (5th Ed., 1925) 1530.

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* *Missouri Pacific R. R.* v. *Protective Committee*, 135 F. (2d) 741 (C. C. A. 8th, 1943).

Because of such remand, the order on the 1940 Plan cannot even be considered as the law of the case.

Leader v. *Apex Hosiery Co.*, 108 F. (2d) 71 (C. C. A. 3rd, 1939), *aff'd* 310 U. S. 469 (1940).

In any event, the doctrine of the law of the case does not bar contentions which could have been, but were not, raised in connection with the prior proceeding.

Mutual Life Ins. Co. v. *Hill*, 193 U. S. 551 (1904).
Connett v. *City of Jerseyville*, 110 F. (2d) 1015 (C. C. A. 7th, 1940).
Chase v. *United States*, 261 Fed. 833 (C. C. A. 8th, 1919).

The District Court itself clearly did not regard its order on the 1940 Plan as constituting a bar. The District Court felt it necessary to try out the whole case on the merits and held that the claim "should be allowed" (R. 31).

Similarly, the Circuit Court stated in its opinion below: "No judicial determination upon the validity of the debt had ever been made * * *" (R. IV, 20), and then it also determined the issue on the merits.

POINT VII

This case is not moot.

This litigation is concerned with orders of allowance of the MOP Claim (see page 25, supra).

We have already demonstrated on pages 26-27 of our main brief how the hearing, order and appeal in this litigation were kept separate from the then pending Plan, and how petitioner's objections to the MOP Claim happened to arise in relation to such Plan.

The orders of allowance of the MOP Claim in issue will determine the ultimate disposition of the assets of MOP and NOTM, when the reorganization is concluded. Such orders patently have significance, irrespective of any particular plan.

Cf. *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307, 324 (1939).

The determination on the merits of this case will settle this matter for any future plan of reorganization. The case is therefore in no sense moot.

This is clearly demonstrated by the conclusion of Judge Learned Hand, speaking for the unanimous Circuit Court of Appeals for the Second Circuit in *Knight* v. *Wertheim*, 158 F. (2d) 838 (C. C. A. 2d, 1946), *cert. denied sub nom. McGuire* v. *Equitable Office Bldg. Corp.*, 331 U. S. 818 (1947).

Respondents conclude their brief with an appeal to this Court to bar consideration of the merits of the MOP Claim because of the length of time the debtor railroads have been in reorganization proceedings. However, the decision of this Court on the merits obviously will not involve any delay.

The delay in these reorganization proceedings has not been caused by petitioner or by the litigation on the intercompany claim.

Respondents bear the responsibility. Twice—in 1943 and 1947—they themselves abandoned plans of which they had been the leading proponents, and requested the Circuit Court of Appeals for the Eighth Circuit to remand the plans—approved by the District Court—to the Commission.

If any comment on this situation be called for, it should not be with respect to petitioner who has sought an adjudication of a claim asserted by a fiduciary parent against a dominated subsidiary deprived of the protection of an independent trustee.

CONCLUSION

It is respectfully submitted that the order and judgment of the Circuit Court of Appeals for the Eighth Circuit be reversed and that the cause be remanded with directions that the MOP Claim be disallowed or subordinated to the claims of the holders of MOP 5¼% Secured Serial Gold Bonds.

Respectfully submitted,

WILLIAM H. BIGGS,
Attorney for Petitioner,
Security Building,
St. Louis 2, Missouri.

PHILLIP I. BLUMBERG,
of Counsel.